

VZCZCXRO7617
RR RUEHBZ RUEH DU RUEHJO RUEHMR RUEHRN
DE RUEHSA #1056/01 1401320
ZNR UUUUU ZZH
R 191320Z MAY 08
FM AMEMBASSY PRETORIA
TO RUEHC/SECSTATE WASHDC 4491
RUCNSAD/SOUTHERN AF DEVELOPMENT COMMUNITY COLLECTIVE

UNCLAS SECTION 01 OF 05 PRETORIA 001056

CIMS NTDB WASHDC
DEPT OF COMMERCE WASHDC
DEPT OF TREASURY WASHDC
AMCONSUL JOHANNESBURG
AMCONSUL CAPE TOWN
AMCONSUL DURBAN

DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR TRINA RAND
USTR FOR COLEMAN

SIPDIS

E.O. 12958: N/A
TAGS: [ECON](#) [EFIN](#) [EINV](#) [ETRD](#) [EMIN](#) [EPET](#) [ENRG](#) [BEXP](#) [KTDB](#) [SENV](#)
PGOV, SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWS WEEKLY NEWSLETTER MAY 16, 2008
ISSUE

11. (U) Summary. This is Volume 8, issue 20 of U.S. Embassy Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:

- Mboweni Favors Further Rate Hike
 - International Groups Believes SA Cannot Grow Faster Than 3.5%
 - Commodity Prices to Drive Growth
 - House Prices to fall in Real Terms
 - Net Reserves Down on Lower Gold Price
 - SAA Restructuring Program on Track, but Profit-Margins Shrink as Fuel Prices Rise
 - SAA to Realign Its Fleet to Include More Fuel-efficient Aircrafts
 - SAG Unveils New Power Pricing Policy
 - Eskom Price Hike Unlikely to Go Through
 - Eskom Takes Steps to Finalize Nuclear Power Supplier Selection Process
 - Treasury Concedes on Mining Royalties
 - Interest Grows in MTN Acquisition
 - HP Acquires SA IT Services Company
 - Durban Hosts Africa's Largest Travel Trade Show
- End Summary.

Mboweni Favors Further Rate Hike

12. (U) South African Reserve Bank (SARB) Governor Tito Mboweni sent a clear message that interest rates will rise again at the next Monetary Policy Committee (MPC) meeting in June, stating that price pressures have spread well beyond food and fuel and must be contained. "We can't say that the inflation problem we are facing is just because of food and energy, it's more generalized," he announced after the SARB published a twice-yearly monetary policy review. When the MPC started raising interest rates in June 2006, the main concern was the effect of high domestic demand on inflation, the SARB report said. But now the inflation landscape was dominated by "a succession of supply-side shocks", which include a weaker rand and the likelihood of steep electricity price hikes, which the SARB now sees as South Africa's main inflation threat. Mboweni emphasized the importance of anchoring inflation expectations, which have deteriorated significantly this year. Interest rates have already increased by a cumulative 4.5 percentage points since June 2006, taking prime lending rates up to 15% and curbing consumer demand, the economy's main engine of growth. Mboweni dismissed suggestions that South Africa's inflation targeting policy was not working, although the annual rise in the

CPIX price gauge has exceeded its 3%-6% official target for a full year, rising by a five-year peak of 10.1% last month. "Any central bank worth its salt will want to contain inflation at lower levels ... I promise you we are going to do our job, come hell or high water", he said. Mboweni said that monetary policy had become "particularly challenging" for all inflation targeting countries with many exceeding targets due to the effect of soaring global food and fuel prices. At its policy meeting last month, the MPC said inflation was expected to peak at an average 9.3% in the first quarter of this year and return to its target only by the end of next year. (Business Day, May 15, 2008)

International Groups Believes SA Cannot Grow Faster Than 3.5%

13. (U) A Harvard-led group of international experts said, in final recommendations released by the National Treasury, South Africa's rapid pace of economic growth over the past three years was well above a sustainable "potential" growth level of about 3.5%. This is well below the South African Reserve Bank (SARB)'s sustainable growth estimate of 4.5%. The Harvard group said South Africa's pace of growth, which amounted to about 5% during each of the past three years, was unsustainable as it was driven by domestic demand. To achieve an official goal of boosting growth to a sustainable annual rate of 6% by the start of the next decade, South Africa should focus on creating jobs that boosted exports. The group said the biggest constraint to growth was that only 42.6% of South Africa's working-age population was employed, compared with 65% in comparable countries. The group urged the SAG to stick to its conservative fiscal policies and inflation targeting, which has come under fire as soaring food and fuel prices force the SARB to continue raising interest rates. The group also suggested that the SARB control currency volatility, which has been cited as a big impediment to

PRETORIA 00001056 002 OF 005

growth. The panel did not recommend a specific level for the rand, which has depreciated by 13% against major currencies this year. Growth is expected to slow to well below 4% this year. (Business Day, May 9, 2008)

Commodity Prices to Drive Growth

14. (U) Finance Minister Trevor Manuel stated that the prices of commodities such as gold and platinum will remain at near record levels, fueling overall economic growth in Africa. "There is nothing to suggest that they [prices] will come off in the short to medium-term," Manuel said during an interview in Maputo, Mozambique, where he was attending the annual meeting of the African Development Bank. "The demand for metals and mineral commodities will remain strong." Manuel also said that investment into countries such as South Africa, Zambia, and other metals producers has picked up as metal prices have climbed to new heights, driven by demand from China and India. (Business Day, May 14, 2008)

House Prices to fall in Real Terms

15. (U) According to the latest ABSA house price index, house price growth slowed to 6.8% y/y in nominal terms in April, the lowest in eight and a half years. ABSA Home Loans Senior Property Analyst Jacques du Toit said that further price drops were expected in real terms and while some price growth in nominal terms was still expected this year, this would be at much lower levels towards the end of the year. "Currently we are looking at an overall drop in real terms of just over 4% in 2008. In nominal terms, growth of between 5% and 6% is expected for this year," said Du Toit. He said higher interest rates were driving real prices down, and that households were also coming under increasing pressure from sharply rising food and fuel prices. Du Toit expects the property cycle to bottom out in 2009 after which there will be a gradual recovery when interest rates start to drop. (Business Day, May 11, 2008)

Net Reserves Down on Lower Gold Price

16. (U) The South African Reserve Bank announced that net gold and

foreign exchange reserves fell from \$33.1 billion in March to \$33.0 billion in April, the first decline in almost two years. The decline was mainly a result of a lower gold revaluation, which subtracted \$261 million from the reserves as the gold revaluation price fell from \$937 per ounce in March to \$872 per ounce in April. The SARB has said it will continue to build reserves to help cushion the country against external shocks, particularly with the current account deficit at 7.3% of GDP in 2007. The SARB brought a long-standing negative position in reserves into balance early in 2004 with the elimination of its loss-making forward foreign exchange book, historically the Achilles' heel of the currency. However, South Africa's foreign exchange still lags holdings in other emerging economies. (Business Day, May 11, 2008)

SAA Restructuring Program on Track, but Profit-Margins Shrink
as Fuel Prices Rise

17. (U) South African Airways (SAA) CEO Khaya Ngqula, announced that the airline is still on track to meet the objectives set out in its restructuring plan initiated in 2007, but it was possible that a projected 7.5% profit margin would not be reached by the end of 2009, due to soaring oil prices. The upward movement of oil prices during its 2007/8 financial year wiped R950 million (\$125 million) off the airline's bottom-line. However, Ngqula stressed that SAA's financial position had improved through fleet downsizing. SAA has also implemented aggressive oil and currency hedging programs to mitigate the risk for 2008/9. CFO Kaushik Patel indicated that it was now working on a 3% to 6% margin range, which would be heavily dependent on fluctuations in the rand/dollar exchange rate as well as the oil price. Initial planning had been done at an oil price of \$84 per barrel for 2008/9, but SAA was now working with scenarios between \$84 and \$150 per barrel. SAA is considering the use of fuel surcharges to offset rising oil prices, but Ngqula indicated that it would not be in a position to pass through the full costs of rising fuel prices. A R6 million (\$800,000) incentive scheme, designed to retain highly skilled staff, had also received board approval. During the past year, 963 SAA employees took voluntary retrenchment packages and a further 869 resigned, making forced retrenchments

PRETORIA 00001056 003 OF 005

unnecessary. Ngqula admitted that many skilled employees had left its employ, and the exodus had taken a particular toll on SAA Technical (SAAT), its maintenance unit. SAAT is in the process of appointing 100 replacements, including 23 technicians recruited from bankrupt competitor Nationwide, and that it would continue to recruit. He said SAA continued to 'unbundle' its business into its seven distinct components, a process that should be finalized by midyear. A recent FAA audit of SAAT that was leaked to the local press expressed concern over SAAT's loss of technical personnel, noting that if SAAT continued to lose personnel at the current pace, it would not be able to adequately provide maintenance for SAA and the other international airlines that it serves. (Business Report, May 13, 2008)

SAA to Realign Its Fleet to Include More Fuel-efficient
Aircrafts

18. (U) South African Airways (SAA) issued a request for information (RFI) to Airbus and Boeing to form part of a new fleet plan. Fuel efficiency would underpin the RFI for the "next-generation" fleet, which would be introduced from 2014, as well as the "bridging fleet", to be operated between 2010 and 2014. According to the press announcement, a formal request for proposals (RFP) would be compiled on information garnered from the RFIs. SAA is expected to then outline the number of aircraft sought, as well as the purchase and funding scenarios, which are likely to involve a mix of outright aircraft purchases and leasing arrangements. SAA could seek to initiate a competitive bidding process between Boeing and Airbus later this year, probably built around Boeing's B-787 series and Airbus' A350s. These planes are viewed as considerably more energy efficient than the current operational fleet. According to press reports, SAA might also consider the purchase of an Airbus A-380 super carrier. In the meantime, SAA issued a firm RFP to aircraft manufacturers and leasing organizations for six aircraft to join its

current Airbus-dominated fleet during the course of 2008/9. Three of these would need to be wide-bodied aircraft for international and long-haul African routes, while the balance would comprise narrow-bodied planes to service domestic and regional capacity. CEO Khaya Ngqula said that SAA's restructuring plan had created the financial platform for growth and that SAA was now poised to add capacity to 11 existing routes and add a brand-new service to Maun, Botswana, in the coming months. Business Development Head Jason Krause explained the airline would add capacity to the Cape Town, Luanda, Dar es Salaam, Entebbe, Victoria Falls, Mauritius, Mumbai, Frankfurt, Munich, Perth and Sao Paulo routes in the immediate-term and that the six leased aircraft would be crucial to achieving this goal. Last year, SAA grounded its fleet of six Boeing 747-400s. Three of these aircraft were returned to the leasing entities, one had been sub-leased to TAAG of Angola, and the last two would also be subleased. Krause said the RFP for the additional six aircraft incorporated SAA's desire for fleet simplification in the immediate-term, which implied that it would seek to add additional Airbus capacity. (Engineering New, May 13, 2008)
QAirbus capacity. (Engineering New, May 13, 2008)

SAG Unveils New Power Pricing Policy

¶9. (U) A new electricity pricing policy was approved by Cabinet this week, details of which were announced on May 16 at the national stakeholder summit on electricity. The summit focused primarily on Eskom's request for a 60% tariff hike for the 2008/9 determination period, as well as South Africa's future pricing policy.

"Preliminary discussions between government and all the key stakeholders were taking place to ensure that consensus is reached at the summit," Government Spokesperson Themba Maseko said following Cabinet's meeting. Cabinet endorsed a "smoothing mechanism" for tariffs. It is now unlikely that the National Energy Regulator of South Africa, which is scheduled to hold public hearings into Eskom's application on May 23 and make a determination on June 6, would approve the full 60% nominal increase requested. A Cabinet statement said the policy sought to ensure that the electricity value chain:

- * contributed to economic growth;
- * provided universal access to electricity;
- * created an investor-friendly pricing structure, which promotes efficient cost recovery measures and a reasonable return on investment;
- * guaranteed an environmentally friendly usage of resources;
- * provided an open and nondiscriminatory access to the transmission system; and

PRETORIA 00001056 004 OF 005

- * created greater levels of transparency on electricity prices to the users.

The Cabinet statement made no reference, however, to a possible increase in the size of the shareholder injection that might be required to sustain Eskom's financial ratios and its credit rating in view of the lower-than-requested tariff increases. (Engineering News, May 15, 2008)

Eskom Price Hike Unlikely to Go Through

¶10. (U) Business and labor groups called for the creation of a multi-stakeholder group to debate the funding options for State-owned power utility Eskom's R343 billion (\$46 billion) expansion projects. Speaking at the National Energy Summit on May 16, Congress of South Africa Trade Unions (COSATU) General Secretary Zwelinzima Vavi said that a five-to-ten person committee should meet to thrash out the "best possible solution" in the context of the current emergency. The summit was called for after rolling power cuts plagued the country and state power company Eskom requested a 60% nominal tariff increase. Eskom's request to augment the 14.2% hike it had been granted in 2007 has unleashed a wave of opposition.

Vavi did not discount the need to raise prices to deal with the funding challenge, but suggested that the state funding role should be properly debated. Business Unity South Africa Chairperson Bobby Godsell acknowledged that the crisis was primarily of government's making, but said it would be unhelpful simply to seek scapegoats. Instead, he said lessons should be learned from the failure of all

participants to deliver on the 1998 White Paper, which warned that SA would run short of power in 2007. He called for both an immediate-term focus, to overcome the upcoming winter, and a medium-term focus, which dealt with the pricing architecture. Vavi also rejected any notion that workers and the poor should bear the brunt of the pain for "other people's mistakes". He also lambasted the unilateral actions taken by Eskom to cut power to the mines and factories, saying such unilateralism on the issue of rationing should never be allowed to take place again. Minister of Minerals and Energy, Buyelwa Sonjica attended the summit along with other senior government officials. Eskom appears to have lost support even from the government in its plea for an immediate and drastic hike in electricity tariffs. Instead, the government has shifted towards supporting a cash injection for the utility to permit five years of smaller, incremental hikes. The emerging consensus between the SAG, business, labor and the African National Congress and its allies is that a sudden price shock would deliver irreparable harm to the economy and add significantly to inflation and interest rate concerns. (Engineering News, May 16, 2008 and Business Day, May 16, 2008)

Eskom Takes Steps to Finalize Nuclear Power Supplier Selection
Process

¶11. (U) State electricity utility Eskom requested Best and Final Offers from Westinghouse and Areva. The two companies have bid to build a fleet of power plants in South Africa supplying up to 20,000 megawatts of power. The Westinghouse N-Powerment Team submitted a Qmegawatts of power. The Westinghouse N-Powerment Team submitted a proposal in response to the Eskom request. Eskom is expected to review the Westinghouse and Areva offers over the next few weeks, and make a recommendation to its Board in June to select to a single supplier. The next steps include the development of an Early Works contract so the successful supplier can begin ordering materials.

Treasury Concedes on Mining Royalties

¶12. (U) National Treasury has made major concessions on mining royalties to accommodate the mining industry's fear of being overtaxed under a new royalty regime. Cabinet-approved amendments to the Mineral and Petroleum Resources Royalty Bill will introduce a distinction between the royalties imposed on refined minerals (such as gold) and unrefined minerals (including diamonds, gas and oil), which will have their own formulas. The amendments also lower the base for calculating the tax. Chamber of Mines Chief Economist Roger Baxter said that National Treasury had not yet discussed the amendments with the Chamber, so he could not give a definitive comment, but the Chamber appreciated the Treasury's willingness to

PRETORIA 00001056 005 OF 005

engage on the issues. (Business Day, May 14, 2008.)

Interest Grows in MTN Acquisition

¶13. (U) India's leading mobile operator Bharti Airtel has contacted Middle Eastern sovereign wealth funds in a search for additional cash to back a bid for a majority stake in South Africa's MTN Group, according to press reports. Bharti, which said it was in talks with MTN but had not made any bid yet, was reported to be considering offering R160-165 (\$21-22) a share for a 51% stake in MTN that would cost \$19 billion. A combination of Bharti and MTN would create the world's sixth-biggest mobile firm with around 130 million subscribers. Singapore Telecommunications, Bharti's largest shareholder with more than a 30% stake, is actively involved in the talks between Bharti and MTN. Emirates Telecommunications (Etisalat) said it was also looking at MTN as a possible acquisition target as part of Africa expansion plans. (Engineering News, May 13, 2008)

HP Acquires SA IT Services Company

¶14. (U) Hewlett-Packard's (HP) imminent \$13.9 billion takeover of Electronic Data Systems (EDS) is expected to strengthen both companies' operations in the South African technology services market, which is dominated by local entities such as arivia.kom, Business Connexion and Gijima Ast. HP recently entered the South African IT services market. EDS generated an estimated revenue of more than R400 million (\$53 million) in 2007. Frost & Sullivan Technology Analyst Lindsey McDonald said EDS had seen steady growth and was "very well respected" within the industry for its expertise in storage techniques. (Business Report, May 15, 2008)

Durban Hosts Africa's Largest Travel Trade Show

¶15. (U) Thousands of visitors traveled to KwaZulu-Natal (KZN) for the 2008 Tourism Indaba, Africa's biggest travel trade show. The Indaba took place at the Durban International Convention Center May 10-13. Deputy Minister of the Department of Environmental Affairs and Tourism Rejoice Mabudafhasi announced at the opening session that South Africa was on track to receive 10 million tourists per year by 2010. The 2008 Tourism Indaba attracted 1,850 exhibiting companies and over 15,000 delegates from more than 80 countries. This marked a 14 percent growth in the number of delegates from ¶2007. The growth in the number of delegates this year provided a boost for the regional economy as delegates participated in city tours and add-on events throughout the province. The Indaba focused on leveraging tourism growth opportunities presented by the 2010 FIFA World Cup. (Tourism Indaba Daily News, May 10-13, 2008)

BALL